Bath & North East Somerset Council		
MEETING:	**Cabinet**	
MEETING DATE:	**1st February 2017**	
TITLE:	**Treasury Management Monitoring Report to 31st December 2016**	EXECUTIVE FORWARD PLAN REFERENCE: E 2923
WARD:	All	
AN OPEN PUBLIC ITEM		

List of attachments to this report:

Appendix 1 – Performance Against Prudential Indicators
Appendix 2 – The Council's Investment Position at 31st December 2016
Appendix 3 – Average monthly rate of return for 1st 9 months of 2016/17
Appendix 4 – The Council's External Borrowing Position at 31st December 2016
Appendix 5 – Arlingclose's Economic & Market Review Q3 of 2016/17
Appendix 6 – Interest & Capital Financing Budget Monitoring 2016/17
Appendix 7 – Summary Guide to Credit Ratings

1 THE ISSUE

1.1 In February 2012 the Council adopted the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, which requires the Council to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year.

1.2 This report gives details of performance against the Council's Treasury Management Strategy and Annual Investment Plan 2016/17 for the first nine months of 2016/17.

2 RECOMMENDATION

The Cabinet agrees that:

2.1 the Treasury Management Report to 31st December 2016, prepared in accordance with the CIPFA Treasury Code of Practice, is noted

2.2 the Treasury Management Indicators to 31st December 2016 are noted.

3 RESOURCE IMPLICATIONS

3.1 The financial implications are contained within the body of the report.

4 STATUTORY CONSIDERATIONS AND BASIS FOR PROPOSAL

4.1 This report is for information only.

5 THE REPORT

Summary

5.1 The average rate of investment return for the first nine months of 2016/17 is 0.49%, which is 0.13% above the benchmark rate.

5.2 The Council's Prudential Indicators for 2016/17 were agreed by Council in February 2016 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

Summary of Returns

5.3 The Council's investment position as at 31st December 2016 is given in **Appendix 2**. The balance of deposits as at 31st December 2016 are also set out in the pie charts in this appendix.

5.4 The Council is the accountable body for the West of England Revolving Investment Fund (RIF) and received grant funding of £57 million at the end of the 2011/12 financial year, the value of the fund as at 31st December 2016 is £28.7 million. The Council acts as an agent and holds these funds until they are allocated in the form of repayable grants to the constituent Local Authorities to meet approved infrastructure costs. These funds are invested separately from the Council's cash balances they are therefore excluded from all figures given in this report.

5.5 The Council also continues to act as Accountable Body for the West of England Local Enterprise Partnership (WoE LEP). In 2016/17 it has received £42.407m of Local Growth Fund (LGF) from Central Government following submission of its Strategic Economic Plan. This sum, prior to distribution, is being invested in line with the Council's overall Treasury Management Strategy, with the interest earmarked to fund support and governance costs. The balances related to the LGF are included in the figures given in this report.

5.6 Gross interest earned on investments for the first nine months totalled £314k. Net interest, after deduction of amounts due to Schools, Local Growth Fund and other internal balances, is £148k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 0.49%, which was 0.13% above the benchmark rate of average 7 day LIBID +0.05% (0.36%).

Summary of Borrowings

5.7 The Council repaid £31.3m in borrowing, taking replacement borrowing of £23m in the three months to 31th December 2016 reducing the total current borrowing to £120.0 M.

5.8 The Council's Capital Financing Requirement (CFR) as at 31st March 2016 was £182.5 million with a projected total of £266 million by the end of 2016/17 based on the capital programme approved at February 2016 Council. This represents the Council's underlying need to borrow to finance capital expenditure, and demonstrates that the borrowing taken to date relates to funding historical capital spend.

5.9 Following Local Government Reorganisation in 1996, Avon County Council's residual debt is administered by Bristol City Council. All successor Unitary Authorities make an annual contribution to principal and interest repayment, for which there is a provision in the Council's revenue budget. The amount of residual debt outstanding as at 31st March 2016 apportioned to Bath & North East Somerset Council is £13.40m. Since this borrowing is managed by an external body and treated in the Council's Statement of Accounts as a deferred liability, it is not included in the borrowing figures referred to in paragraph 5.7.

5.10 The borrowing portfolio as at 31st December 2016 is shown in **Appendix 4**.

Strategic & Tactical Decisions

5.11 As shown in the charts at **Appendix 2**, the investment portfolio has been diversified across UK Banks and Building Societies, Local Authorities and very highly rated Foreign Banks. The Council also uses AAA rated Money Market funds to maintain very short term liquidity. The Council has £13.5M invested in Money Market Funds as at 31st December 2016.

5.12 The Council does not hold any direct investments with banks in countries within the Eurozone reflecting both on the underlying debt issues in some Eurozone countries and the low levels of interest rates. The Council's investment counterparty list does not currently include any banks from Portugal, Ireland, Greece, Spain and Italy.

5.13 The Council's current average investment return is in broadly line with the budgeted level of 0.45%.

Future Strategic & Tactical Issues

5.14 Our treasury management advisors economic and market review for the second quarter 2016/17 is included in **Appendix 5**.

5.15 The Bank of England base rate was reduced to 0.25% on 4th August 2016. In the opinion of the Council's treasury advisors there is unlikely to be a rate rise until Q3 2018.

5.16 These lower rates reinforce the benefits of the Council's current policy of internal borrowing (although it is recognised this could be adversely impacting elsewhere including pension liabilities) and this continues to be monitored regularly against the likelihood that long term borrowing rates are forecast to rise in future years. The focus is now on the rate of increase and the medium-term peak and, in this respect, the current forecast remains that rates will rise slowly and to a lower level than in the past.

Budget Implications

5.17 A breakdown of the revenue budget for interest and capital financing and the forecast year end position based on the period April to December is included in **Appendix 6** and shows a forecast underspend of £680,000 reflecting savings from capital programme slippage delaying the need to borrow and a lower Minimum Revenue Provision (MRP) requirement

5.18 This position will be kept under review during the remainder of the year, taking into account the Council's cash-flow position and the timing of any new borrowing required.

6 RATIONALE

6.1 The Prudential Code and CIPFA's Code of Practice on Treasury Management requires regular monitoring and reporting of Treasury Management activities.

7 OTHER OPTIONS CONSIDERED

7.1 None.

8 CONSULTATION

8.1 Consultation has been carried out with the Cabinet Member for Community Resources, Section 151 Finance Officer and Monitoring Officer.

8.2 Consultation was carried out via e-mail.

9 RISK MANAGEMENT

9.1 The Council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment and Borrowing advice is provided by our Treasury Management consultants Arlingclose.

9.2 The CIPFA Treasury Management in the Public Services: Code of Practice requires the Council nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The Corporate Audit Committee carries out this scrutiny.

9.3 In addition, the Council maintain a risk register for Treasury Management activities, which is regularly reviewed and updated where applicable during the year.

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Background papers	*2016/17 Treasury Management & Investment Strategy*
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1
Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. Authorised limit for external debt

These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

	2016/17 Prudential Indicator	Actual as at 31st December 2016
	£'000	£'000
Borrowing	266,000	120,004
Other long term liabilities	2,000	0
Cumulative Total	**268,000**	**120,004**

2. Operational limit for external debt

The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.

	2016/17 Prudential Indicator	Actual as at 31st December 2016
	£'000	£'000
Borrowing	229,000	120,004
Other long term liabilities	2,000	0
Cumulative Total	**231,000**	**120,004**

3. Upper limit for fixed interest rate exposure

This is the maximum amount of total borrowing which can be at fixed interest rate, less any investments for a period greater than 12 months which has a fixed interest rate.

	2016/17 Prudential Indicator	Actual as at 31st December 2016
	£'000	£'000
Fixed interest rate exposure	**229,000**	**100,004***

* The £20m of LOBO's are quoted as variable rate in this analysis as the Lender has the option to change the rate at 6 monthly intervals (the Council has the option to repay the loan should the Lender exercise this option to increase the rate).

4. Upper limit for variable interest rate exposure

While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping flexibility through the use of variable interest rates. This is the maximum amount of total borrowing which can be at variable interest rates.

	2016/17 Prudential Indicator	Actual as at 31st December 2016
	£’000	£’000
Variable interest rate exposure	**141,000**	**20,000**

5. Upper limit for total principal sums invested for over 364 days
This is the maximum amount of total investments which can be over 364 days. The purpose of this indicator is to control the Council’s exposure to the risk of incurring losses by seeking early repayment of its investments.

	2016/17 Prudential Indicator	Actual as at 31st December 2016
	£’000	£’000
Investments over 364 days	**50,000**	**0**

6. Maturity Structure of borrowing
This indicator is set to control the Council’s exposure to refinancing risk.

	Upper Limit	Lower Limit	Actual as at 31st December 2016
	%	%	%
Under 12 months	50	Nil	8.3*
12 months and within 24 months	75	Nil	0
24 months and within 5 years	75	Nil	8.3
5 years and within 10 years	100	Nil	0
10 years and above	100	Nil	83.4

* The CIPFA Treasury management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date (which are at 6 monthly intervals for the £20m of LOBO’s). However, the Council would only consider repaying these loans if the Lenders exercised their options to alter the interest rate.

7. Average Credit Rating
The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio. A summary guide to credit ratings is set out at **Appendix 7**.

	2016/17 Prudential Indicator	Actual as at 31st December 2016
	Rating	Rating
Minimum Portfolio Average Credit Rating	**A-**	**AA+**

APPENDIX 2

The Council’s Investment position at 31st December 2016
The term of investments, from the original date of the deal, are as follows:

As per Weekly	**Balance at 31st December 2016**
	£’000’s
Notice (instant access funds)	15,066
Up to 1 month	6,000
1 month to 3 months	13,000
Over 3 months	26,000
Total	**60,066**

The investment figure of £96.7 million is made up as follows:

	Balance at 31st December 2016
	£’000’s
B&NES Council	18,080
West Of England Growth Points	134
Local Growth Fund	35,166
Schools	6,686
Total	**60,066**

The Council had a total average net positive balance of £84.663m during the period April 2016 to December 2016.

Chart 1: Council Investments as at 31st December 2016 (£60.1m)

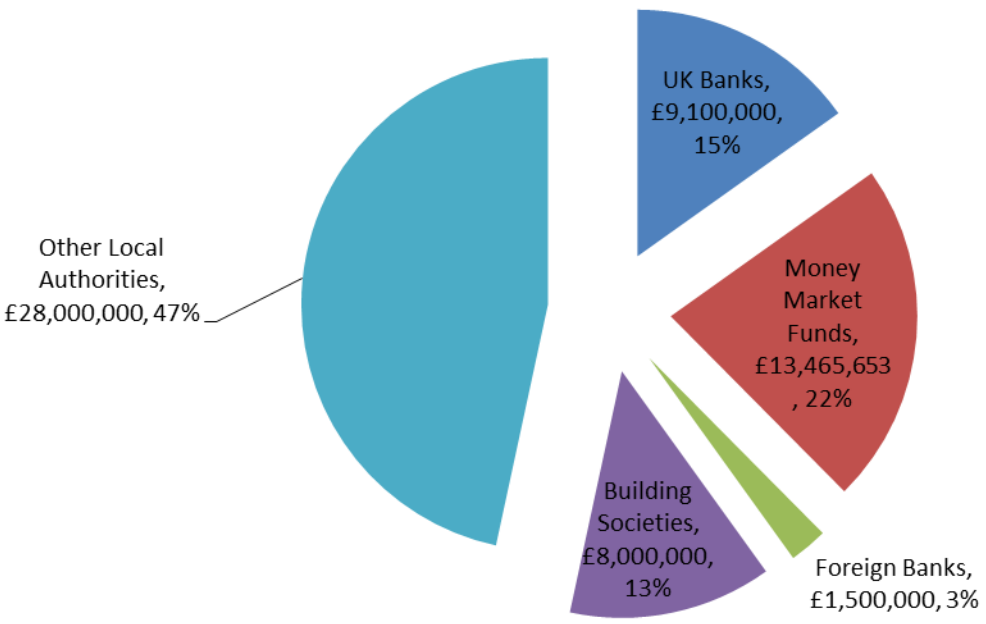


Chart 2: Council Investments as at 30th September 2016 (£86.7m)

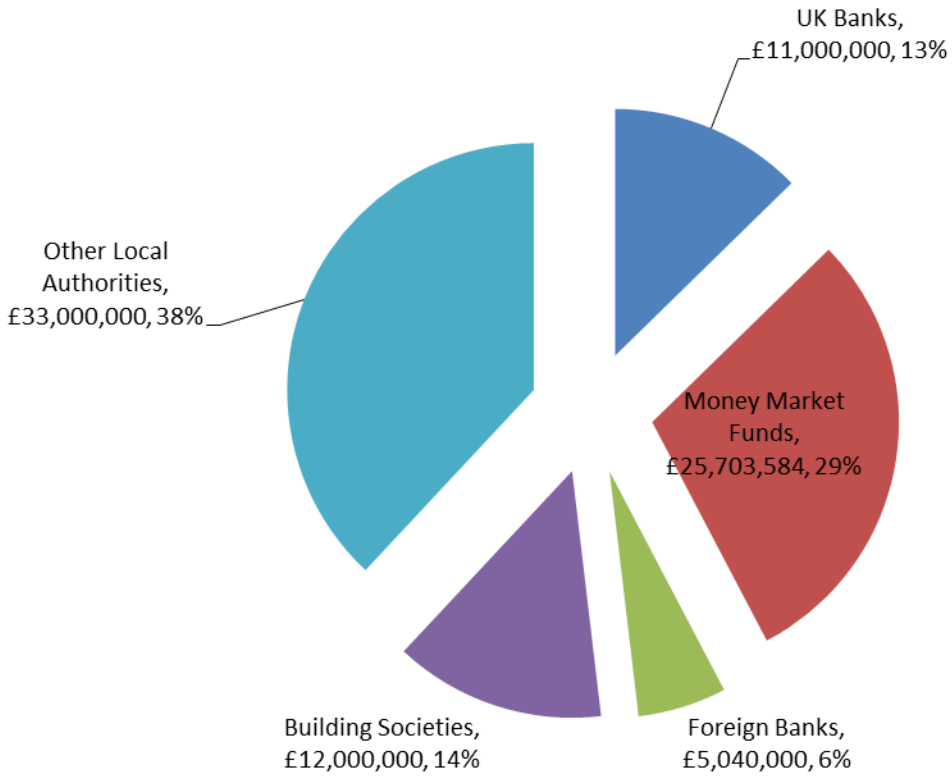


Chart 3: Council Investments per lowest equivalent Long Term credit rating (£60.1m) 31st December 2016

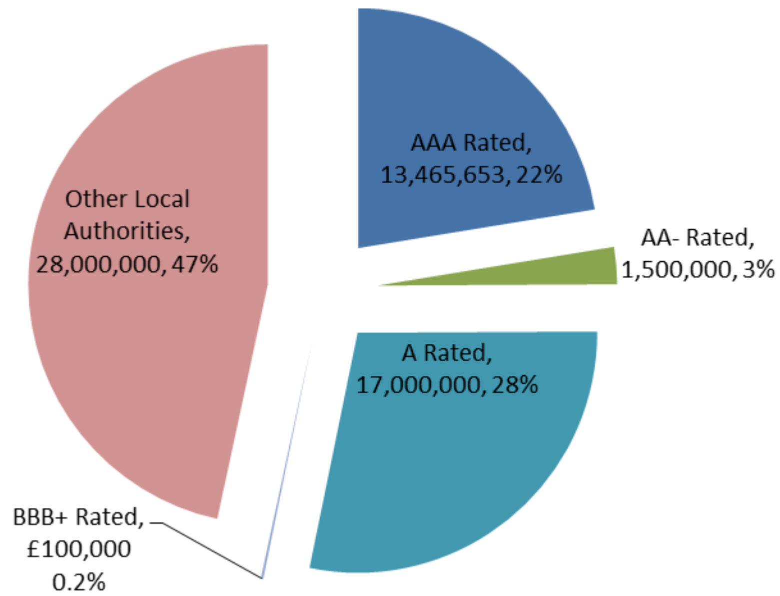
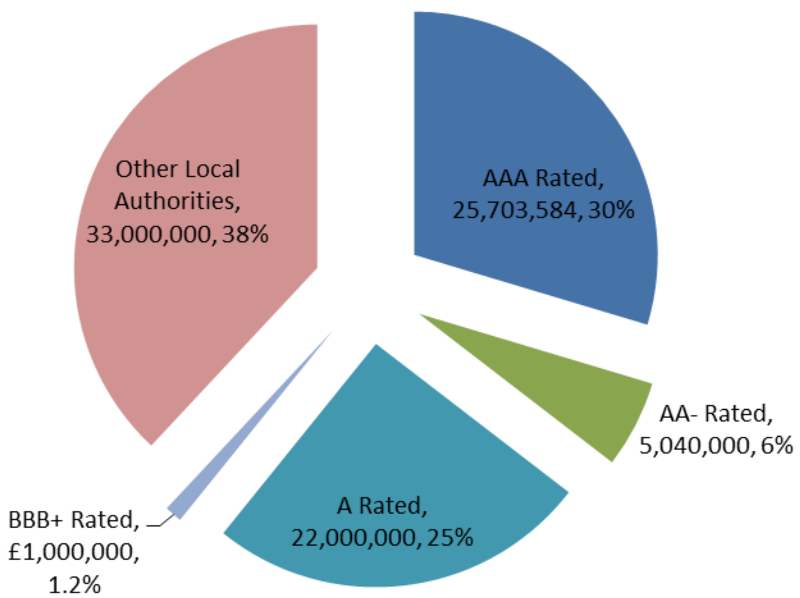


Chart 4: Council Investments per lowest equivalent Long Term credit rating (£86.7m) 30th September 2016



APPENDIX 3

Average rate of return on investments for 2016/17

	April %	May %	June %	July %	Aug %	Sept %	
Average rate of interest earned	0.45	0.52	0.52	0.52	0.51	0.49	
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.41	0.42	0.41	0.41	0.36	0.33	
Performance against Benchmark %	+0.04	+0.10	+0.11	+0.11	+0.15	+0.16	

	Oct %	Nov %	Dec %				Average for Period
Average rate of interest earned	0.48	0.45	0.45				**0.49%**
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.31	0.24	0.23				**0.36%**
Performance against Benchmark %	+0.17	+0.21	+0.22				**+0.13%**

APPENDIX 4

Councils External Borrowing at 31st December 2016

LONG TERM	Amount	Start Date	Maturity Date	Interest Rate
PWLB	10,000,000	15/10/04	15/10/35	4.75%
PWLB	5,000,000	12/05/10	15/08/35	4.55%
PWLB	5,000,000	12/05/10	15/08/60	4.53%
PWLB	5,000,000	05/08/11	15/02/31	4.86%
PWLB	10,000,000	05/08/11	15/08/29	4.80%
PWLB	15,000,000	05/08/11	15/02/61	4.96%
PWLB	5,300,000	29/01/15	15/08/29	2.62%
PWLB	5,000,000	29/01/15	15/02/61	2.92%
PWLB	19,704,175	20/06/16	200641	2.36%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
Eurohypo Bank*	10,000,000	27/04/05	27/04/55	4.50%
Gloucestershire County Council	5,000,000	25/11/14	25/11/19	2.05%
Gloucestershire County Council	5,000,000	19/12/14	19/12/19	2.05%

Middlesbrough Borough Council	5,000,000	6/12/16	06/01/17	0.26%
Middlesbrough Borough Council	5,000,000	15/12/16	15/02/17	0.29%
TOTAL	**120,004,175**			
TEMPORARY	**Nil**			
TOTAL	**120,004,175**			**3.43%**

*All LOBO's (Lender Option / Borrower Option) have reached the end of their fixed interest period and have reverted to the variable rate of 4.50%. The lender has the option to change the interest rate at 6 monthly intervals. Should the lender use the option to change the rate, then at this point the borrower has the option to repay the loan without penalty.

APPENDIX 5

Economic and market review for October to December 2016 (provided by Arlingclose)

Following the sharp decline in household, business and investor sentiment that was prompted by the unexpected outcome of the referendum in Q2, the preliminary estimate of Q3 2016 GDP defied expectations as the economy grew 0.5% quarter-on-quarter, down only slightly from 0.7% in Q2 and year/year growth running at a healthy pace of 2.3%.

Economic data continued to challenge the current sentiment throughout the quarter. Consumer Price Inflation (CPI) fell to 0.9% in October but rose to 1.2% in November, both predominantly driven by clothing, fuel and hotel prices although the Office for National Statistics (ONS) were quick to point out that there was little evidence to link this rise to the decline in the value of sterling. With sterling having now fallen by around 20% with its impact on prices still to come, according to the ONS, CPI will be heading close towards the Bank of England's target rate of 2% in the first half of 2017, consistent with the forecasts contained within the Bank's last quarterly Inflation Report issued in November 2016.
After a weak August, British consumers picked up the pace of their spending in Q3. UK retail sales growth surged to a 14-year high in October as consumers kept spending and colder weather boosted clothing sales. According to the British Retail Consortium (BRC), fears over Brexit are likely to weigh on sales in the period ahead.

Labour market data also proved resilient, showing a small rise in the level of unemployment by 10,000, and average earnings dipping slightly, but at 2.3% still delivering real earnings growth although clearly under pressure from higher prices. The ILO unemployment rate remained at 4.9%, its lowest level in 11 years.

In the August meeting, the Bank of England's Monetary Policy Committee (MPC) stated that the majority of members expected to support a further cut in Bank Rate to its effective lower bound at one of the MPC's forthcoming meetings during the course of the year. In the final calendar quarter of 2016 the MPC kept Bank Rate unchanged at 0.25% and asset purchases at £435 bn.

In a further twist to an extraordinary year in political events, the US voted Donald Trump as the 45th President of the United States who will take up office on 20th January 2017. Uncertainty surrounds whether or not the President-elect will make good the fiscal, regulatory and policy initiatives and changes which were central to his campaign and, if so, their timing and size and their effect on growth, employment and inflation both domestic and globally.

Following a strengthening labour market, in a move that was largely anticipated, at its meeting in December, the Federal Reserve's Open Market Committee (FOMC) increased the target range for official interest rates for just the second time in the last decade. The range was increased to between 0.5% and 0.75%, from 0.25% and 0.5%. In the accompanying statement Fed Chair Janet Yellen also highlighted the expectation of three further rate hikes in 2017, followed by three hikes in each of 2018 and 2019.

Market reaction

Following the referendum result, gilt yields fell sharply across the maturity spectrum on the view that Bank Rate would remain extremely low for the foreseeable future.

Since September there has been a recovery in longer dated gilt yields, largely due to the MPC revising its earlier forecast that Bank rate would be dropping to near 0% by the end of 2016. The yield on the 10-year gilt rose from 0.75% at the end of September to 1.24% at the end of December, which is almost back at pre-Brexit levels of 1.37% on 23rd June. 20- and 50-year gilt yields have also risen considerably in the third quarter to 1.76% and 1.7% respectively, and are nearly back up to pre-Brexit levels.

However, this recovery was not realised across all maturities. The 1 year gilt yield dropped from 0.13% at the end of September to -0.004% at the end of December. The one year gilt yield first went negative at the beginning of December, having only been negative intra-day previously. 2 and 3 year gilt yields have also continued to fall.

Movements in gilt yields are reflected in the PWLB borrowing rates, as evidenced in Tables 2 and 3 in Appendix 2.

After recovering from an initial sharp drop in Quarter 2, equity markets appear to have continued their rally, although displaying some volatility at the beginning of November following the US presidential election result. The FTSE-100 and FTSE All Share indices closed at 7142.83 and 3873.22 respectively on 30th December, up 3.5% and 3.1% over the quarter.

Money market rates for very short-dated periods (overnight to 1 month) have largely started recovering from a noticeable fall in the previous quarter. 7-day and 1-month LIBID rates increased by about 0.1%, to 0.35% and 0.61% respectively. Longer-dated periods (6 months to 2 years) also increased by between 10 and 20 basis points; on 30th December the 6-month LIBID rate was 0.64%, 12-month 0.81% and the 2-year swap rate 0.60%.

Credit Commentary

At the end of November, the Bank of England released the results of its latest stress tests on the seven largest UK banks and building societies (Barclays, HSBC, Lloyds/Bank of Scotland, Santander UK, HSBC, RBS/Natwest and Nationwide BS). The 2016 stress tests were more challenging and designed under a new Bank of England framework, which tested the resilience of banks to tail risk events; events perceived to be very low probability but particularly wide-reaching and severe (a big downturn in global economic global conditions, a peak-to-trough decline in UK GDP of 4.3% alongside a 4.3% rise in unemployment, a 30% decline in house prices and a 42% decline in commercial real estate). Royal Bank of Scotland, Barclays and Standard Chartered Bank were found to be the weakest performers.

During the stress test process, RBS had identified the capital deficits which were likely to be revealed and updated its capital plan to incorporate further capital strengthening actions. The revised plan was accepted by the Prudential Regulation Authority (PRA). The regulator drew attention to the severity of the stress test for Standard Chartered's business model, which is exposed to both Asian and commodity markets. (This bank is currently suspended from the Authority's lending list for new investments.)

The stress tests were based on banks' financials as at 31st December 2015; one of the main short-comings of these tests is that by the time the results are published, they are 11 months out of date for most banks. As part of its creditworthiness research and advice, the Authority's treasury advisor Arlingclose regularly undertakes analysis of relevant ratios - "total loss absorbing capacity" (TLAC) or "minimum requirement for eligible liabilities" (MREL) - to determine whether there would be a bail-in of senior investors, such as local authority deposits, in a stressed scenario.

Changes to long-term credit ratings over the quarter included Moody's upgrades to rating of both Barclays Bank and Suisse to A1 and to Santander UK plc's rating to Aa3 from A1. S&P upgraded the long-term rating of Goldman Sachs International Bank to A+ from A.

APPENDIX 6

Interest & Capital Financing Costs – Budget Monitoring 2016/17 (July to December)

April to June 2016	**YEAR END FORECAST** **Budgeted Spend or (Income) £'000**	**Forecast Spend or (Income) £'000**	**Forecast over or (under) spend £'000**	**ADV/FAV**
Interest & Capital Financing				
- Debt Costs	5,404	5104	(300)	FAV
- Internal Repayment of Loan Charges)	-6200	-6200	0	
- Ex Avon Debt Costs	1,240	1,240	0	
- Minimum Revenue Provision (MRP)	7,115	6855	(260)	FAV
- Interest on Balances	-79	-199	(120)	FAV
Sub Total - Capital Financing	**7480**	**6920**	**(680)**	**FAV**

APPENDIX 7

Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicate san issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.